

## Chapter 21: Exam practice question

### Variance analysis at Oasis Cookers Ltd

1 Define the following terms:

a budgeted figures (2)

These are the detailed estimated sales and cost figures for a future period. They may be based on past real figures, adjusted for future expectations or, for a new business or product, may be based on estimates derived from market data and market research. They may be used as performance targets and can be used in order to logically allocate scarce resources.

b variance. (2)

This is the difference between the actual performance figures and the budgeted figures. This is used to review progress. If variance figures show that performance is below budgeted figures, strategy and tactics may be changed so that target figures may be better met by the end of the budgeted period.

Apply **Resources table 3a** mark band descriptors.

2 Explain how a manufacturing business sets budgets for sales and costs. (4)

Sales:

- Past figures may be extrapolated in order to forecast future sales.
- These may be adjusted for:
  - market expectations, based on market data
  - economic expectations.
- Seasonal forecasts may be prepared using moving-average analysis (HL).

Costs:

- Costs break down into fixed and variable costs. Fixed costs may not change much from period to period but this will need questioning before the forecast is done.
- Variable costs are based on expected sales volumes. They may be based on past pricing but are more likely to be adjusted for expected future pricing of supplies, labour and any other variable cost component.

Apply **Resources table 3b** mark band descriptors.

- 3 Complete the table by calculating the variances, indicating whether they are adverse or favourable. (6)

\$000	Budgeted figures	Actual figures	Variance	Adverse or favourable
Sales revenue	165	150	(15)	Adverse
Cost of materials	80	70	(10)	Favourable
Labour costs	22	23	1	Adverse
Gross profit	63	57	(6)	Adverse
Overheads	40	43	3	Adverse
Net profit	23	14	(9)	Adverse

**6 marks:**

A completely correct table.

**4–5 marks:**

One or two minor errors.

**2–3 marks:**

An attempted table with some adverse/favourable labels incorrect.

**1 mark:**

An attempted table with most adverse/favourable labels incorrect and some variances incorrectly calculated.

- 4 Using the variance results, comment on the performance of Oasis Cookers during the year. (4)
- Sales were down by 9.1%. This is probably due to the recession and the higher value of the currency, which makes exports more difficult. There is also increased competition from foreign imports.
  - Labour costs went up 4.5%. Oasis should examine labour productivity figures. It could be that they have kept the same number of workers despite the lower than expected sales.
  - Overheads were up by 7.5%. This could be due to higher interest paid on loans since interest rates went up.
  - Materials costs were down 12.5%. This could be due to more competitive pricing during a recession. If Oasis imports its materials, they would appear to be cheaper since the currency appreciated.
  - Both gross and net profit were hence less than budgeted.

1 mark for every variance explained fully.

No marks for just repeating the information in the question 3 variance table.

5 Evaluate the usefulness of budgets to a business such as Oasis Cookers.

(7)

Useful:

- make managers consider future plans carefully so realistic targets can be set
- make sure business does not spend more resources than it has access to
- motivational – people work better if they have a target
- make different departments plan and then coordinate with each other
- plans require monitoring and controlling and so make managers constantly review action and tactics
- useful to assess performance after the end of the budget period
- any other valid point

Not useful:

- take a long time to prepare – this time has an opportunity cost
- they can rarely be 100% accurate
- the budgeting process involves most departments – special training may be needed to be able to do this
- failure to meet targets, for whatever reason, may be used negatively against staff when there may be very good reasons that targets have not been reached
- any other valid point

SL: apply **Resources table 1** mark band descriptors.

HL: apply **Resources table 2** mark band descriptors.

A justified conclusion is required for an ‘evaluate’ question.